IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE:	§	
	§	
KENNETH R. DAVIS, A/K/A	§	CASE NO. 00-46377-BJH-11
KENNETH DAVIS, D/B/A KEN DAVIS	§	
FARMS, and WIFE, LEATHA G. DAVIS,	§	
	§	
Debtors.	§	

BANK OF AMERICA, N.A.	§	
	§	
Plaintiff,	§	
	§	
- against -	§	Adversary No. 01-4024
	§	
KENNETH R. DAVIS, A/K/A	§	
KENNETH DAVIS, D/B/A KEN DAVIS	§	
FARMS, and WIFE, LEATHA G. DAVIS,	§	
	§	
Defendants.	§	

MEMORANDUM OPINION

Before the Court is the Complaint to Determine Dischargeability of Debt (the "Complaint") filed by Bank of America, N.A. ("Bank of America" or the "Bank") against Kenneth R. Davis ("Davis") and his wife, Leatha G. Davis ("Mrs. Davis") (Davis and Mrs. Davis will be referred to collectively as the "Debtors"). The Court heard the evidence over several days. Following the close of the evidence, the parties asked for the opportunity to file post-trial briefs. Under an agreed scheduling order, the last of those briefs was filed on March 1, 2002. The Court heard final oral argument on March 14, 2002.

The Court has jurisdiction over the parties and the Complaint in accordance with 28 U.S.C.

§§ 1334 and 157. The Complaint is a core proceeding in accordance with 28 U.S.C. § 157(b)(2)(I). This Memorandum Opinion contains the Court's findings of fact and conclusions of law in accordance with Bankruptcy Rule 7052.

I. FACTUAL BACKGROUND

The Debtors are husband and wife. Davis is a farmer and rancher, and has been in the cattle business (and certain other related agricultural businesses) for many years.[1] In his farming operations, Davis raises wheat, grains, cotton and certain other grazing crops. Other business activities include cattle hauling and trucking, and the sale of fertilizer and other related farm supplies. Davis has also been involved in the cattle order-buying business pursuant to which a client places an order for certain types of cattle, Davis fills the order at a livestock auction and delivers the cattle to the client, for which Davis is paid a commission. However, Davis first started doing business with Bank of America's predecessor in the mid-1980s in connection with his production cattle business. The Bank's line of credit financed the production cattle operation (or, as it is sometimes referred to in the record, the stocker cattle operation).

Mrs. Davis began working in her husband's farming and ranching activities in 1995 or 1996, part time, and began working in the office full time in 1998. Initially, she answered the phone and weighed trucks; later she became involved with the bookkeeping. *See* 12/17/01 Tr. at pp. 24-25.

On September 17, 1996, Davis executed the first of two loan agreements ("Loan Agreement-1") relevant to this case. *See* Bank Exhibit 1. Under Loan Agreement-1, Davis, individually, was

[1]At some point not clear from the record, Davis served on the board of directors of First National Bank of Cleburne. He also served for ten years as a director of the Hillsboro Federal Land Bank and testified that the experience taught him the significance of accurate statements of collateral and loan to value ratios. *See* Transcript of November 8, 2001 hearing (hereinafter cited as "11/8/01 Tr."; other hearing transcripts are cited similarly – first to the date of the hearing and then to the relevant page and, if appropriate, the line reference) at p. 25.

the "Borrower." *See id*. While Mrs. Davis signed Loan Agreement-1, she did so in a limited capacity. Specifically, Mrs. Davis "[a]ccepted and agreed to [Loan Agreement-1] as a pledgor and not as a borrower." *See id*. at p. 7. Loan Agreement-1 constituted loans in the aggregate amount of $2,166,875.00 and set a loan-to-value ratio at 75%.

The parties subsequently amended Loan Agreement-1 four times between August 11, 1997 and December 8, 1998, increasing the aggregate loan amount to $3,661,250 on July 13, 1998, and finally setting a maximum loan amount of $3,500,000 on December 8, 1998. Davis signed a renewal promissory note each time the loan amount was increased. On July 31, 1997, Davis executed a renewal promissory note ("Note-1") in the original principal amount of $3,000,000.00. *See* Bank Exhibit 7. On December 8, 1997, Davis executed another renewal promissory note ("Note-2") in the original principal amount of $3,300,000. *See* Bank Exhibit 11. On July 13, 1998, Davis executed a third renewal promissory note ("Note-3") in the original principal amount of $3,500,000.00. *See* Bank Exhibit 17. Note-1, Note-2, and Note-3 represented the increase in the aggregate amount available under Loan Agreement-1. Mrs. Davis did not execute Note-1, Note-2, or Note-3 in any capacity. Thus, Davis was the sole obligor on Note-1, Note-2, and Note-3.

Bank of America is a national banking association. On or about June 5, 1999, NationsBank changed its name to Bank of America. By virtue of the name change, Bank of America received all of NationsBank's rights and interests in Loan Agreement-1, Note-1, Note-2, and Note-3. Thus, the Bank is the owner, holder, and entity entitled to enforce those documents against the Debtors.

In an effort to reconcile the Davis account, the Bank consolidated the debt into a fourth renewal note. On June 30, 1999, Davis executed this fourth renewal note ("Note-4") in the original principal amount of $2,261,500.06, representing the total outstanding balance he owed to the Bank.

See Bank Exhibit 34. Once again, Mrs. Davis did not execute Note-4. As each note was executed, that note became the "live" lending instrument.

Davis also executed two security agreements, one dated September 17, 1996 ("Security Agreement-1"), and the other dated November 25, 1998 ("Security Agreement-2")(collectively, the Security Agreements"). *See* Bank Exhibits 2 and 26. In the Security Agreements, Davis granted Nationsbank (now Bank of America) a lien on inventory, cattle, livestock, and all products and proceeds derived therefrom.[2] Mrs. Davis also signed the Security Agreements and agreed to their terms as a "debtor/pledgor" of collateral.

On March 9, 2000, Davis, as the "Borrower," and the Bank entered into a second loan agreement, with an effective date of January 1, 2000 ("Loan Agreement-2"). *See* Bank Exhibit 39. Mrs. Davis signed Loan Agreement-2 "for purposes of evidencing her agreement to and acceptance of same." *See id*. at p. 15. Under Loan Agreement-2, the Bank agreed to forebear collection of Note-4 which was then in default. The Bank also agreed to extend, rearrange, and modify Note-4 to allow Davis to liquidate the Bank's collateral and use the proceeds to pay down the outstanding debt. Under Loan Agreement-2, Davis agreed to liquidate the Debtors' production cattle to meet the payment schedule set forth in that agreement. Ultimately, Davis failed to make the payments required under Loan Agreement-2.

Also on March 9, 2000, Davis and the Bank executed an Amended Extension, Rearrangement and Modification Agreement, with an effective date of January 1, 2000 (the

[2]The Bank had the first lien on the production livestock cattle. While Davis owned other cattle from time to time in connection with his other business ventures (*i.e.*, the Davis-Perkins cattle partnership), Davis agrees that these cattle were kept separate and the numbers of cattle in dispute here does not involve these other cattle. *See* 11/8/01 Tr. at p. 116-117. *See also* Bank Exhibit 39 at ¶ I.B.1.a. (where other cattle, including Davis-Perkins partnership cattle, are excluded from the Bank's lien).

"Extension Agreement"). *See* Bank Exhibit 40. Once again, Mrs. Davis signed the Extension Agreement "for purposes of evidencing her agreement to and acceptance of same." The Extension Agreement renewed Note-4 by creating a new promise to pay $2,180,815.12 and extended the maturity date to August 31, 2000. The Extension Agreement provided that: (i) $27,000 was due on January 1, 2000; (ii) $50,000 was due on February 1, 2000, March 1, 2000, and April 1, 2000; (iii) $500,000 was due and payable on May 1, 2000, June 1, 2000, July 1, 2000, and August 1, 2000; and (iv) the remaining principal balance was due on August 31, 2000, the maturity date.[3] Davis failed to make the required payments on May 1, 2000, June 1, 2000, and July 1, 2000.

On July 12, 2000, the Bank sent Davis a letter agreement pursuant to which it agreed to forbear from collection provided that Davis made weekly payments of $200,000.00 and the Bank could have another appraisal of its collateral made. *See* Bank Exhibit 46. Davis signed that letter, but noted on it that "the $200,000/wk will be met some wks, but will be short some wks, due to time constraints." *See id*. On July 19, 2000, the Bank sent Davis another letter in which the Bank reiterated its position that in exchange for an agreement to forbear, Davis was required to make the $200,000.00 weekly payments. *See* Bank Exhibit 47. Davis signed that letter and returned it to the Bank. These two letters, Bank Exhibits 46 and 47, will be referred to collectively as the "July Letter Agreements." Mrs. Davis did not sign the July Letter Agreements.

From the inception of his loan until mid-1999, Davis provided the Bank with handwritten cattle inventories. *See* Bank Exhibit 4. In addition, Davis provided financial statements from time to time at the Bank's request. *See, e.g.*, Bank Exhibits 12 and 35. Finally, because the relevant loan

[3]The payments were allocated in this manner to coincide with how Davis's production cycle on his pasture cattle would work, *i.e.* he would start selling the cattle in May because that was the start of the prime selling season. *See* 11/8/01 Tr. at p. 81, lines 7-15.

documents contained loan to value ratio requirements, Davis also provided compliance certificates from time to time in which he would state, among other things, that as of the date being reported upon "the loan to value calculated in accordance with Section 2.A.(ii) [of Loan Agreement-1] is not more than 75%, *see* Bank Exhibit 3, and/or borrowing base reports that demonstrated the same type of compliance with the applicable loan agreement, *see, e.g.*, Bank Exhibit 24. The Bank also appraised its collateral from time to time. *See, e.g.*, Bank Exhibits 38, 44 and 48. Based upon the handwritten inventories, the financial statements, and the compliance certificates/borrowing base reports that Davis provided, and the appraisals the applicable bank commissioned, Bank of America and its predecessor believed that it was fully secured.

Under the July Letter Agreements, Davis agreed that the Bank could have its collateral appraised yet again. This last appraisal is dated July 26, 2000 and shows that Davis has only 1,833 head of cattle with an approximate value of $1,000,500.00. *See* Bank Exhibit 48. Based upon the cattle counts contained in the Bank's prior appraisals (November 1999 and May 2000) and Davis's last handwritten inventory (July 1999), in excess of 3,000 head of cattle were "missing." As a result of these "missing" cattle, the Bank learned that it was not fully secured.

After learning of this cattle shortage, the Bank filed a lawsuit in federal district court on October 30, 2000 (the "District Court Action") seeking expedited injunctive relief pursuant to Fed. R. Civ. P. 65 and to collect its debt. On November 29, 2000, the Debtors filed their voluntary petition under Chapter 11, thereby commencing the underlying bankruptcy case (the "Case"). On December 21, 2000, the Debtors filed a "Petition and Notice of Removal" of the District Court Action.[4] After applying all of the proceeds received from the sale of its collateral, the Bank filed

[4] Once removed to this Court, the District Court Action was assigned Adv. Pro. No. 00-4181-BJH-11. On August 8, 2001, the Court entered an Agreed Order which consolidated the now removed District Court Action with

an unsecured claim in the Case in the amount of $900,704.19 (the "Claim"). The Debtors have not objected to the Claim.

II. CONTENTIONS OF THE PARTIES

Pleading in the alternative, Bank of America contends that the Claim is nondischargeable in accordance with section 523(a)(2)(A), section 523(a)(2)(B), and/or section 523(a)(6) of the Bankruptcy Code.[5] First, the Bank contends that the financial statements, handwritten cattle inventories, and compliance certificates/borrowing base reports submitted by Davis are statements concerning the Debtors' financial condition that were false, that were made by the Debtors with intent to deceive and upon which the Bank reasonably relied in extending and/or renewing credit to the Debtors. Thus, the Bank contends that the Claim is nondischargeable in accordance with section 523(a)(2)(B). Alternatively, if the Court concludes that the handwritten cattle inventories and compliance certificates/borrowing base reports are not statements concerning the Debtors' financial condition, the Bank contends that the Claim is nondischargeable in accordance with section 523(a)(2)(A).

Second, the Bank contends that Davis made various representations to the cattle appraisers the Bank hired during the inspection and appraisal process. Specifically, the Bank contends that Davis misrepresented both the fact of his ownership of cattle (*i.e.*, those cattle over there in that pasture are mine) and the number of cattle (*i.e.*, I show that there are 400 head in that pasture) to the Bank's appraisers. The Bank further contends that its agent, the appraiser, relied on Davis's

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this adversary proceeding. In that Agreed Order, the parties agreed that the "live pleadings" would be those relied upon in this adversary.

[5]Although broader claims are stated in the Complaint, the parties both executed and submitted to the Court on September 25, 2001 a joint Pre-Trial Order. That Pre-Trial Order narrowed the issues to be tried to those addressed in this Memorandum Opinion.

misrepresentations in preparing the relevant appraisal and that in turn, the Bank itself relied on the appraisal in electing to extend further credit to the Debtors. Thus, the Bank contends that the Claim is nondischargeable in accordance with section 523(a)(2)(A) and/or section 523(a)(2)(B).

Alternatively, if the Court concludes that all of the representations (whether written or oral) concerning ownership and number of cattle were not false, then, according to Bank of America, the only explanation for the missing cattle is that the Debtors sold the Bank's collateral out of trust and failed to turn the proceeds over to the Bank as they were required to do by the relevant loan documents. Thus, the Bank contends that the Claim is nondischargeable in accordance with section 523(a)(6) of the Bankruptcy Code.

The Debtors contend that the Bank failed to prove that the Claim is excepted from discharge in the Case for several reasons. First, the Debtors contend that the Bank failed to prove that they made any false statement regarding ownership or numbers of cattle. In addition, the Debtors contend that the Bank did not rely on any such statements in making its business decision to forebear from collecting Note-4. Rather, the Debtors contend that the Bank relied solely upon its own analysis of the expected costs associated with a liquidation of the cattle inventory and, based upon that assessment, the Bank decided to let Davis liquidate the cattle and turn the proceeds from that liquidation over to the Bank, which he did. Because there was no false statement and/or reliance, the Debtors contend that the Bank failed to carry its burden of proof under either section 523(a)(2)(A) or (B) of the Bankruptcy Code and the Claim is not excepted from discharge in the Case.

Second, the Debtors contend that there is no evidence of any sale of collateral out of trust. Thus, the Debtors contend that the Bank failed to carry its burden of proof under section 523(a)(6)

and the Claim is not excepted from discharge in the Case.

Finally, and in the alternative, Mrs. Davis contends that if the Court concludes that Bank of America has established that it is entitled to have its debt excepted from discharge in connection with some false statement or other conduct of her husband, there is no evidence linking her to the actionable statement or conduct. Thus, Mrs. Davis contends that there is no legal basis for excepting the Claim from her discharge.

III. LEGAL ANALYSIS

The Court will address each of Bank of America's contentions separately.

A. Overview of Section 523(a)(6)[6]

To prevail in its section 523(a)(6) count, Bank of America must prove, by a preponderance of the evidence, a willful and malicious injury by the Debtors to the Bank or its property. *See In re DeVoll*, 266 B.R. 81 (Bankr. N.D.Tex. 2001). In this context, "willful" means intentional. *Id.* at 94. A "willful" injury requires "a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." *See In re Meece*, 261 B.R. 403, 406 (Bankr. N.D.Tex. 2001) (*citing Kawaauhau v. Geiger*, 523 U.S. 57, 64 (1998)). Under the Fifth Circuit's view, a willful and malicious injury occurs where there is an intentional act with "either an objective certainty of harm or a subjective motive to cause harm." *In re Miller*, 156 F.3d 598, 606 (5th Cir. 1998); *In re Grisham*, 245 B.R. 65, 71 (Bankr. N.D. Tex. 2000).

As stated previously, Bank of America contends that the Debtors sold its collateral (the

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[6] Section 523(a)(6) provides:

> (a) A discharge under section ... 1141 ... of this title does not discharge an individual debtor from any debt -
>
> * * *
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity ...

production cattle) out of trust and failed to turn over the proceeds to the Bank as the relevant loan documents required. However, there is simply no evidence that the Debtors sold cattle pledged to the Bank and failed to account for the proceeds from those sales. In fact, the evidence is undisputed that the Debtors made their financial books and records available to the Bank and that the Bank was unable to find any evidence that cattle sales out of trust occurred.

Faced with this absence of evidence, Bank of America contends that if the Court concludes that there is no false statement actionable under either section 523(a)(2)(A) and/or (B) of the Bankruptcy Code – *i.e.*, that the July 1999 handwritten cattle inventory prepared by Davis was not overstated, and that neither the November 1999 nor the May 2000 appraisals were overstated through misrepresentations of Davis, then the only possible explanation for the cattle shortage from the May 2000 appraisal until the July 2000 appraisal is that cattle must have been sold out of trust by the Debtors. Notwithstanding the absence of any direct evidence, Bank of America wants this Court to find that the Debtors sold cattle out of trust by inference from the earlier presence of the cattle and their absence by July 2000.

Because a debtor will rarely, if ever, testify to acting in a willful and malicious manner, a number of cases have held that both elements may be inferred from the circumstances surrounding the injury. *See, e.g., In re Kennedy,* 249 F.3d 576 (6th Cir. 2001) (defamatory statements which were inherently injurious gave rise to inference of intent to injure sufficient to support a § 523(a)(6) claim); *In re Magpusao,* 265 B.R. 492 (Bankr. M.D. Fla. 2001) (intent may be inferred from debtor's conduct and totality of circumstances); *In re Sweeney,* 264 B.R. 866 (Bankr. W.D. Ky. 2001) (willful and malicious injury proven indirectly, by inference, by proof that debtor understood that he was substantially certain to harm creditor or creditor's property where debtor converted insurance

proceeds from collateral upon which creditor had a lien); *In re Sintobin*, 253 B.R. 826 (Bankr. N.D. Ohio 2000) (intent inferred where debtor encouraged children to vandalize landlord's house by spray-painting walls); *In re Halverson*, 226 B.R. 22 (Bankr. D. Minn.1998) (malice inferred as a matter of law where debtor engaged in sexual activity with his eleven year old niece); *In re Adams,* 147 B.R. 407 (Bankr. W.D. Mich. 1992) (intent inferred where debtor sped through red light at congested intersection; debtor should have known that his act was substantially certain to result in serious injury to some person). However, in each of these cases (where a court has held that intent to cause willful and malicious injury can be inferred), the *conduct* was proven, and the intent was inferred by virtue of the egregiousness of the conduct.

Here, the Bank is asking this Court to go one step further. Specifically, the Bank asks this Court to first infer the conduct – sales of cattle out of trust – and, based upon that inferred conduct, make a further inference of willful and malicious intent. The Court is unwilling to go that far. Because there is no direct or even circumstantial evidence that the Debtors sold any Bank collateral out of trust, the Court concludes that this count of the Complaint must fail because the Bank failed to establish the required elements of its section 523(a)(6) claim by a preponderance of the evidence.

A. Overview of Section 523(a)(2)

Bank of America bears the burden of proof and must establish each of the required elements of a claim under section 523(a)(2)(A) and/or (B) of the Bankruptcy Code by a preponderance of the evidence. *See In re Slonaker*, 269 B.R. 595 (Bankr. N.D. Tex. 2001). To prevail on a claim under section 523(a)(2)(A), Bank of America must establish that the Debtors (i) made false representations, (ii) with the intent and purpose of deceiving Bank of America, (iii) that the Bank justifiably relied on the representations, and (iv) that the Bank sustained a loss as a result of the

representations. *See In re Rea*, 245 B.R. 77 (Bankr. N.D. Tex. 2000) (*citing RecoverEdge L.P. v. Pentecost*, 44 F.3d 1284, 1292 (5th Cir.1995)). To prevail on its claim under section 523(a)(2)(B), Bank of America must prove that there is a debt for "money, property, services, or an extension, renewal or refinancing of credit," which was obtained by (i) a statement in writing; (ii) which was materially false; (iii) respecting the Debtors' financial condition; (iv) upon which Bank of America reasonably relied; and (v) that the statement was given with intent to deceive. *In re Slonaker*, 269 B.R. 595, 602 (Bankr. N.D. Tex. 2001).

Breaking the required elements down, Bank of America must first prove that an extension, renewal, or refinancing of debt occurred. In connection with Loan Agreement-2 (executed in March 2000, but effective as of January 2000), the Extension Agreement (executed in March 2000, but effective as of January 2000), and the July Letter Agreements (executed in July 2000), Bank of America agreed to forebear from its collection of Note-4. In addition, the maturity date of Note-4 was extended to August 31, 2000 pursuant to the terms of the Extension Agreement.

Several appellate courts, albeit not the Fifth Circuit, have addressed the issue of whether a forbearance from collection is an "extension, renewal, or refinancing of credit" within the meaning of section 523(a)(2). In *In re Campbell*, 159 F.3d 963 (6th Cir. 1998), the Sixth Circuit concluded that an enforceable agreement to forbear, in exchange for new promises given by a debtor, forms "a deal sufficient to be called a new 'extension of credit.'" *Campbell*, at 966. Similarly, the court in *In re Biondo*, 180 F.3d 126, 133 (4th Cir. 1999) drew strong analogy between a forbearance and an extension of credit and stated that a forbearance alone "very likely" constitutes an extension of credit. The Fourth Circuit stated that "a forbearance agreement extends the debtor-creditor relationship beyond the period originally contemplated and can appropriately be labeled a credit

extension." *Biondo*, at 133. *See also In re Gerlach*, 897 F.2d 1048, 1050 (10th Cir. 1990) (the "Code, therefore, protects a creditor who is deceived into forbearing from collection without being given an opportunity to grant or deny the extension of credit"); *cf. Field v. Mans*, 157 F.3d 35 (1st Cir. 1998) (a failure to accelerate a debt is tantamount to an extension of credit).

Although the lower courts are split, *compare Chapman v. Frakes*, 1991 WL 247602 (N.D.Ill. 1991) *with In re Bacher*, 47 B.R. 825 (Bankr. E.D. Pa.1985), this Court aligns itself with the overwhelming weight of appellate authority and concludes that a forbearance agreement constitutes an "extension of credit" within the meaning of section 523(a)(2). Given its ordinary meaning, the word "extension" is broad enough to encompass a forbearance agreement.[7] Thus, the Court concludes that Bank of America has established that there was an extension of credit by it when it signed Loan Agreement-2, the Extension Agreement, and the July Letter Agreements.

Bank of America must next prove that its extension of credit was "obtained by" either (i) the Debtors' "false pretenses, false representations or actual fraud," other than a statement respecting their financial condition, *see* 11 U.S.C. § 523(a)(2)(A), or (ii) the Debtors' use of a written statement concerning their financial condition that was materially false, which the Debtors made or caused to be published with the intent to deceive, and on which Bank of America reasonable relied, *see* 11 U.S.C. § 523(a)(2)(B). As is clear from the literal language of the statute itself, nondischargeability claims under section 523(a)(2)(A) and (B) are mutually exclusive. Numerous courts have so held. *See, e.g., First Nat'l Bank of Olathe v. Pontow*, 111 F.3d 604 (8th Cir. 1997); *In re Kirsh*, 973 F.2d 1454 (9th Cir. 1992); *In re Moore*, 118 B.R. 64 (Bankr. N.D. Tex. 1990).

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[7] *Black's Law Dictionary* defines the term "extension" as a "period of additional time to take an action, make a decision, accept an offer, or complete a task." It defines the term "forbearance" as "[t]he act of refraining from enforcing a ... debt."

Thus, if the Debtors obtained the extension of credit by using a false statement concerning their financial condition, the statement must be in writing for the claim to be actionable. *See* 11 U.S.C. § 523(a)(2)(B). Alternatively, if the Debtors obtained the extension of credit through false pretenses, false representations, or actual fraud, then the underlying false statement which supports the Bank's claim must be about something other than the Debtors' financial condition. Accordingly, this Court must analyze each of the alleged false statements at issue to determine if they are a "statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(B). If they fall within that category of statements – they concern the debtor's or an insider's financial condition – then they must be in writing to be actionable in dischargeability litigation. Oral false statements respecting financial condition are not excepted from discharge under the Bankruptcy Code.[8]

Bank of America contends that the financial statements, handwritten cattle inventories, and compliance certificates/borrowing base reports submitted by Davis are statements concerning the Debtors' financial condition under section 523(a)(2)(B). Obviously, the formal financial statements submitted by Davis to Bank of America are statements concerning the Debtors' financial condition and the issue of their alleged falsity will be addressed below. Bank of America also contends that the handwritten cattle inventories and compliance certificates/borrowing base reports should be

[8] Courts have recognized that while some frauds, such as false oral statements respecting financial condition, may go unredressed as a result of section 523(a)(2)(B)'s writing requirement, courts will "be called upon less often to preside over 'swearing matches,' where parties' assertions are contradictory but no written evidence is presented." *In re Redburn*, 202 B.R. 917, 926 (Bankr. W.D. Mich. 1996). However, the legislative history on this point - the requirement of a writing when the alleged false statement concerns the debtor's financial condition - is not particularly helpful. The House Report suggests that "Congress wanted to moderate the burden on individuals who submitted false financial statements, not because lies about financial condition are less blameworthy than others, but because the relative equities might be affected by practices of consumer finance companies, which sometimes have encouraged such falsity by their borrowers for the very purpose of insulating their own claims from discharge." *See Field v. Mans*, 516 U.S. 59, 77 (1995). The Supreme Court has also stated that Congress "may have been concerned with the peculiar potential of financial statements to be misused not just by debtors, but by creditors who know their bankruptcy law." *Id*.

governed by section 523(a)(2)(B) because, although they are not classic financial statements, the number of cattle the Debtors owned and the estimated value of that cattle was of such importance to their overall net worth and to the Bank's evaluation of its collateral. Specifically, during closing argument, counsel for Bank of America stated that

> In terms of the number and value of the cattle that [Davis] was submitting to Bank of America in the handwritten inventories – this was the type of information that the Bank was specifically relying upon in order to renew and extend its line of credit. That was the main thing they would look at in terms of his financial condition – was how much collateral does he have, how much collateral is there to adequately secure this loan. So in that regard, we believe those hand-written inventories *do* reflect his financial condition.

Audio tape: Status Conference (Mar. 14, 2002) (on file with Court).

The only other statements relied upon by Bank of America in support of the Complaint are the oral statements allegedly made by Davis to the appraisers hired by Bank of America to inspect and appraise the production cattle. These oral statements, however, present a significant strategic dilemma for the Bank. If the statements about the number of production cattle which the Debtors owned in the handwritten inventories and compliance certificates/borrowing base reports are statements concerning the Debtors' financial condition, then it is logical to conclude that the oral statements concerning the same facts are also statements concerning the Debtors' financial condition. If so, Bank of America cannot satisfy the writing requirement of section 523(a)(2)(B) and its Complaint fails to the extent it relies upon these alleged false oral statements. As a result of this dilemma, Bank of America asks this Court to cut a very fine line – and to find that while oral statements concerning the *number* of cattle present in a particular pasture may be statements concerning the Debtors' financial condition that must be in writing, oral statements about the mere fact of *ownership* of cattle in a particular pasture are not statements concerning the Debtors'

financial condition, and thus, no writing is required. *See* 11 U.S.C. § 523(a)(2)(A). In short, the Bank argues that Davis's oral statement to the appraiser, as they were driving by a pasture during the appraisal process, that "those are my cattle" is not a statement concerning the Debtors' financial condition, but a statement that "those are my 50 cattle" is a statement concerning the Debtors' financial condition.

With this predicate in mind, the Court will address Bank of America's contentions and decide which statements allegedly made by Davis fall within section 523(a)(2)(A) and which statements fall within section 523(a)(2)(B).

Neither the definitional section of the Code, 11 U.S.C. § 101, nor any other section, define the term "statement" or the phrase "statement respecting . . . financial condition." *See In re Redburn*, 202 B.R. 917 (Bankr. W.D. Mich. 1996). The courts which have tried to divine its meaning can be roughly divided into two camps. The first line of cases has adopted a limited view, and has held that the phrase "statement respecting the debtor's . . . financial condition" as used in section 523(a)(2)(B) means traditional formal financial statements such as balance sheets, profit/loss statements, and statements of net worth.[9] They have done so for several reasons. First, they conclude that the ordinary usage of the word "statement," in the context of a discussion about finances, denotes some sort of balance sheet or accounting of assets and liabilities. *See, e.g., In re Olinger*, 160 B.R. 1004 (Bankr. S.D. Ind. 1993); *In re Sansousy*, 136 B.R. 20 (Bankr. D.N.H. 1992). Second, they rely on policy – a broad construction of the phrase, pulling within its ambit a wide variety of statements, may result in more frauds going unredressed and more plaintiffs being denied

[9] Black's Law Dictionary defines the term "financial statement" as "a balance sheet, income statement, or annual report that summarizes an individual's or organization's financial condition on a specified date or for a specified period by reporting assets and liabilities." *Black's Law Dictionary*, 7th ed. (1999).

a remedy simply because they did not have the foresight to require a writing. *See, e.g., In re Alicea*, 230 B.R. 492 (Bankr. S.D.N.Y. 1999). And finally, they rely upon legislative history – floor statements by Representative Edwards and Senator DeConcini which refer to section 523(a)(2)(B) as being directed to the use of "the so-called false financial statement." *See* 124 Cong. Rec. H11096 (daily ed. Sept. 28, 1978) (statement of Rep Edwards); 124 Cong. Rec. S17412 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini); *see also In re Mercado*, 144 B.R. 879 (Bankr. C.D. Cal. 1992).

The other group, and emerging majority, of cases adopts what has been termed a "broad," "liberal," or "expansive" view. *See, e.g., In re Redburn*, 202 B.R. 917 (Bankr. W.D. Mich. 1996). Those courts have defined the phrase to encompass a much broader class of statements, such as those which relate to even a single asset or liability. *See, e.g., In re VanSteinburg*, 744 F.2d 1060 (4th Cir. 1984). They have done so on the ground that "Congress did not speak in terms of financial statements, but instead, referred to a much broader class of statements relating to financial condition." *Van Steinburg*, 744 F.2d at 1061. They have also considered the nature and purpose of the statement. Where the debtor makes a statement which materially affects the debtor's overall financial condition, and makes it to induce the creditor to lend, it is appropriately considered a statement respecting the debtor's financial condition within the meaning of section 523(a)(2)(B). *See, e.g., In re Ransford*, 202 B.R. 1 (Bankr. D. Mass. 1996) (holding that oral statement of ownership of real property, made to reassure creditor that debtors owned sufficient assets to satisfy debt, was statement respecting the debtors' financial condition).

The Court concludes that the latter cases present the better view. The problem with the notion that the bill's sponsors referred in floor statements to the "so-called false financial statements" is that the bill itself failed to use that phrase. It is true that in business circles, such as

those traveled by Bank of America, the ordinary usage of the word "statement" in connection with the word "financial" often denotes particular documents. It is also true that the phrase "financial statement" is almost a term of art. But it is a term of art which Congress failed to use; Congress chose broader language. And while it may be true that under a liberal construction of the phrase, a greater number of frauds may go unredressed because the creditor did not obtain a writing, that is a policy choice which Congress has apparently made by requiring a writing when the statement at issue respects the debtor's financial condition.

Bank of America agrees with this latter line of cases as well. At the final oral argument, counsel for the Bank reiterated the Bank's position that the phrase "statements respecting the debtor's . . . financial condition" in section 523(a)(2)(B) is broad enough to encompass Davis's cattle inventories and compliance certificates/borrowing base reports when he stated:

> Mr. Massouh: Bank of America's position is that 523(a)(2)(B) are [sic] not limited to just pure formal financial statements – they are statements 'respecting the debtor's financial condition.'
>
> The Court: That's because, implicit in that information, is information about the bank's collateral. That's really the only thing about Mr. Davis's financial condition you cared about – how many cows did he have and what did he think the value of those cows were.
>
> Mr. Massouh: Correct. Correct.

Audio tape: Status Conference (Mar. 14, 2002) (on file with Court).

Applying its conclusion here – that the phrase "statements respecting the debtor's . . . financial condition" is broad enough to include more than formal financial statements, the Court returns to the Bank's dilemma. If statements about the number of cattle owned by the Debtors contained in the handwritten inventories and compliance certificates/borrowing base reports are statements concerning the Debtors' financial condition (as the Bank contends), shouldn't the Court

also conclude that oral statements concerning the same facts are statements concerning the Debtors' financial condition? As noted previously, to escape this logical conclusion, the Bank asks this Court to cut a very fine line – and to find that while oral statements concerning the *number* of cattle present in a particular pasture may be statements concerning the Debtors' financial condition that must be in writing, oral statements about the mere fact of *ownership* of cattle in a particular pasture are not statements concerning the Debtors' financial condition and thus, no writing is required.

The Court is unwilling to draw such a fine distinction between the statements "I own those cattle" and "I own those 50 cattle." While numbers of cattle were of significance to the Bank, that information was only relevant if it was attributable to the Debtors' ownership. It would be of no concern to Bank of America that there were 50 cattle in a leased pasture unless the Debtors owned those 50 cattle. On the facts of this case, the attributes of ownership and number are so intertwined as to render their separation impossible.

Thus, the Court concludes that (i) the handwritten cattle inventories submitted by Davis from time to time are statements respecting the Debtors' financial condition, (ii) the compliance certificates/borrowing base reports submitted by Davis from time to time are statements respecting the Debtors' financial condition, (iii) the statements contained in the November 1999 appraisal, represented by Davis as being correct in connection with his execution of Loan Agreement-2, are statements respecting the Debtors' financial condition, (iv) the alleged oral statements made by Davis to Bank of America's appraiser during the appraisal process regarding the number of cattle present in a particular pasture or pen are statements respecting the Debtors' financial condition, and (v) the alleged oral statements made by Davis to Bank of America's appraiser during the appraisal process regarding his ownership of cattle in a particular pasture or pen are statements respecting the

Debtors' financial condition. As the latter two categories are oral statements respecting the Debtors' financial condition, they do not fall within either section 523(a)(2)(A) or section 523(a)(2)(B), and the Complaint fails to the extent it relies upon those alleged statements. Each of the remaining alleged false statements will be analyzed below under section 523(a)(2)(B).

1. Statements Concerning the Debtors' Financial Condition - Section 523(a)(2)(B)

a. Written financial statements

Davis submitted written financial statements to the Bank (or its predecessor) from time to time. *See, e.g.,* Bank Exhibits 12 and 35. The last of these written financial statements was dated as of July 1, 1999. *See* Bank Exhibit 35; *see also* 11/8/01 Tr. at p. 73. That financial statement reflects that the Debtors had equipment and other business assets with a value of $4,654,105.00. *See id.; see also* 11/8/01 Tr. at pp. 69-70. Davis testified that of that aggregate value, approximately $3 million represented the value of the cattle owned by the Debtors that were subject to the Bank's lien. *See* 11/8/01 Tr. at pp. 71-72. This representation of value of the Bank's collateral (as contained in the July 1999 financial statement) is consistent with the July 1999 handwritten cattle inventory and the July 1999 borrowing base report which Davis submitted to the Bank. *Compare* Bank Exhibit 24 (July 1999 borrowing base report; value of approximately $2.9 million), *with* Bank Exhibit 4 (July 1999 handwritten cattle inventory; value of approximately $3.1 million); *see also* discussion of these other July 1999 documents at pp. 21-23, *infra*.

For the reasons discussed in more detail below, *see* pp. 21-23, *infra*, the Court declines to infer misrepresentations by Davis in connection with the July 1999 financial statement as the Bank requests. The Bank asks this Court to infer false statements or misrepresentations by Davis in the July 1999 financial statement because if the May 2000 appraisal is incorrect, as the parties now

agree, then the July 1999 financial statement, handwritten cattle inventory, and borrowing base report must also be incorrect and Davis must have made false statements or misrepresentations to the Bank in those documents. Because the Court refuses to infer a false statement or misrepresentation in light of Davis's unequivocal and credible testimony that he correctly reported the number and estimated value of cattle to the Bank in July 1999, *see* pp. 22-23, *infra*, the Court finds that the Bank failed to carry its burden of proof and establish by a preponderance of the evidence that Davis made a false statement or misrepresentation to the Bank in the July 1999 financial statement regarding the value of the Bank's collateral. Thus, the Court concludes that the Complaint fails to the extent it relies upon alleged false statements or misrepresentations contained in the July 1999 financial statement.

b. Written cattle inventories

Davis submitted handwritten cattle inventories to Bank of America and its predecessor from time to time. *See* Bank Exhibit 4. In these handwritten inventories, Davis represented both the number of cattle that were subject to the Bank's lien and his estimated value of those cattle. *Id*. The last handwritten inventory was submitted by Davis to Bank of America in July 1999. *Id.* Davis testified that he knew the Bank was taking the inventories he prepared as a representation of both the number of cattle that were subject to the Bank's lien and the estimated value of those cattle. *See* 11/8/01 Tr. at pp. 53-54.

Not surprisingly, the parties come to different conclusions from the record regarding the falsity of the cattle count stated in the July 1999 handwritten cattle inventory. Davis testified that he counted the cattle himself in connection with the preparation and submission of that inventory to Bank of America. *See* 1/31/02 Tr. at pp. 70-72. Because he prepared the inventory himself,

Davis testified that he is sure of its accuracy. *See id.,* and at pp. 104-105.

In contrast, Bank of America contends that a "very strong inference" can be made that if the May 2000 appraisal is incorrect, as both Bank of America and Davis now agree,[10] then the November 1999 appraisal and the July 1999 handwritten cattle inventory must also be incorrect and Davis must have made false statements or misrepresentations in connection with their preparation. *See* Bank of America proposed findings of fact and conclusions of law filed on September 28, 2001, at ¶¶ 15-27.[11] The May 2000 appraisal shows a count of 5,901 head of cattle. Similarly, the November 1999 appraisal shows a count of 6,262 head of cattle and the July 1999 inventory shows a count of approximately 5,660 head of cattle. Thus, when first received by Bank of America, the May 2000 appraisal appeared to be in line with both the November 1999 appraisal and the July 1999 inventory. It was only after the July 2000 appraisal was prepared that Bank of America learned of the significant shortage in cattle subject to its lien.

The evidence establishes that the May 2000 appraisal is overstated by in excess of 3,000 head of cattle.[12] According to Bank of America, there are only two credible explanations possible for the significant discrepancy in cattle counts from the July/November 1999 time frame to May

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[10]Davis testified that the May 2000 appraisal is overstated by 3,000 head of cattle. *See, e.g.*, 11/8/01 Tr. at p.42, line 18-24.

[11]Because the July 1999 financial statement and the July 1999 borrowing base report make essentially the same representations regarding the value of the Bank's collateral, the Bank contends that the Court should infer that all of these documents were false.

[12]Starting in late April 2000, the Debtors sold small lots of cattle and accounted to Bank of America for such sales by delivering documents evidencing the sales and the sales proceeds to the Bank. The documents included a copy of the check received from the buyer of the cattle detailing the number and types of cattle sold. These documents establish that approximately 1,029 head of cattle were sold by the Debtors from April 24, 2000 to July 28, 2000. Bank of America received payments from these sales totaling $588,333.05. Thus, from the Bank's perspective, within the three-month period between May and July of 2000, 3,039 head of cattle with a value of $1,523,386.95 had either been sold out of trust, otherwise disappeared, or never existed. Davis confirms that the May 2000 appraisal was overstated by about 3,000 head, according to what he was able to later account for in the way of sales. *See* 11/8/01 Tr. at p. 96, lines 13-16.

2000 (as noted, a difference of in excess of 3,000 head of cattle) – either Davis sold cattle out of trust or, more likely, Davis falsely represented the number of cattle he owned in July and November 1999 because those cattle never existed.

As noted previously, there is simply no evidence to suggest that cattle were sold by the Debtors out of trust. Moreover, it is possible that the July 1999 handwritten inventory prepared by Davis correctly represented the number of cattle owned by the Debtors at that time, and that the discrepancy in cattle counts arose in connection with the November 1999 appraisal process or sometime thereafter.

Davis's testimony is unequivocal with respect to the July 1999 handwritten inventory. He personally inspected and counted the cattle, he personally prepared the inventory, and he believes it to be correct in all material respects. *See, e.g.*, 11/8/01 Tr. at pp. 70-72; 1/31/02 Tr. at pp. 104-105. The Court finds Davis's testimony regarding his preparation of the July 1999 inventory to be credible. On this record, and in light of Davis's direct and unequivocal testimony that the July 1999 inventory correctly set forth the number of cattle the Debtors owned and their estimated value, the Court finds that the Bank failed to carry its burden of proof and establish by a preponderance of the evidence that Davis made a misrepresentation to the Bank in the July 1999 handwritten inventory. Thus, the Court concludes that the Complaint fails to the extent it relies upon alleged misrepresentations contained in the July 1999 handwritten inventory.

c. The Compliance Certificates/Borrowing Base Reports

Davis last submitted a borrowing base report to the Bank on July 6, 1999. *See* Bank Exhibit 24. That borrowing base report stated that the Debtors owned cattle with an approximate value of

$2.9 million. As noted previously, that representation of the value of the Bank's collateral is consistent with the July 1999 financial statement (approximately $2.9 million) and the July 1999 handwritten cattle inventory (approximately $3.1 million) submitted by Davis to the Bank. For the reasons discussed above, the Court declines to infer misrepresentations by Davis in connection with the July 1999 borrowing base report as the Bank requests. Because the Court refuses to infer a false statement or misrepresentation in light of Davis's unequivocal and credible testimony to the contrary, the Court concludes that the Bank failed to carry its burden of proof and establish by a preponderance of the evidence that Davis made a misrepresentation to the Bank in the July 1999 borrowing base report regarding the value of the Bank's collateral. Thus, the Court concludes that the Complaint fails to the extent it relies upon alleged misrepresentations contained in the July 1999 borrowing base report.

d. The Cattle Appraisals

Bank of America hired appraisers to inspect and appraise their collateral. Three appraisals are at issue in connection with the section 523(a)(2) claims – the November 1999 appraisal prepared by Charlie Everett, *see* Bank Exhibit 38, and the May and July 2000 appraisals prepared by Clint Barber, *see* Bank Exhibits 44 and 48. The appraisal process generally took several days. *See* 11/8/01 Tr. at pp. 84-85. Davis always accompanied the appraiser. *See id.* and at p. 39, lines 10-12. Because the Debtors' cattle were pastured on both the Debtors' land and on land leased from third parties, Davis would take the appraiser around and show him where the Debtors' cattle were. *See* 11/8/01 Tr. at p. 43, lines 1-6 and pp. 84-85.

At a minimum, the Court finds that Davis made oral representations regarding which cattle the Debtors owned during the appraisal process. As Davis and the appraiser drove by a pasture

where cattle were kept, Davis would point out the Debtors' cattle. There was no other way for the appraiser to know which cattle belonged to the Debtors and were subject to the Bank's lien.

The evidence is disputed with respect to further misrepresentations allegedly made by Davis during the appraisal process. Bank of America contends that at each location where cattle were kept, Davis represented: (i) how many cattle were in the pasture, (ii) that the Debtors owned the cattle in the pasture, and (iii) that the cattle were Bank of America's collateral. Bank of America further contends that the appraiser relied on Davis's representations while making his visual inspection. If the number of cattle Davis represented for each pasture was reasonably close to what the appraiser could see, the appraiser would rely on Davis's number for his final count. Finally, Bank of America contends that Davis knew that Bank of America would be relying on these appraisals to determine its position with respect to the loan and knew that the appraiser's goal was to determine the number and value of the cattle the Debtors owned that were subject to Bank of America's lien.

Davis agrees that he took the appraisers to locations where cattle owned by the Debtors and subject to Bank of America's lien were pastured. Davis admits that he knew that Bank of America would be relying on the appraisal to determine its position with respect to the loan. *See, e.g.,* 11/8/01 Tr. at p. 39, lines 13-16. Davis further admits that he understood that the appraiser's goal was to determine the number and estimated value of the cattle the Debtors owned that were subject to Bank of America's lien. *See* 11/8/01 tr. at p. 43, lines 7-16. Finally, Davis admits that if he was asked for his count of cattle in a particular pasture, he would pull a piece of paper out of his pocket and give the appraiser his count. *See* 11/8/01 Tr. at p. 84, lines 23-25 & p. 85, line 1. However, Davis denies that he gave his count in every instance. *See* 11/8/01 Tr. at pp. 84-85 and at p. 104, lines 22-24. The evidence is undisputed that the appraiser did not ask for, and thus did not receive,

a copy of the paper to which Davis referred in giving any of his cattle counts. *See* 1/31/02 Tr. at p. 71.

Although Bank of America shares responsibility for the manner in which their appraisals were prepared (*i.e.*, cattle were not run through a gate or by a fence to get a more precise head count; rather, they were simply counted by pasture from a truck while driving by the cattle), Bank of America had no way to protect itself from misrepresentations Davis might make regarding ownership of cattle. Bank of America had no way to insure that only the Debtors' production cattle were counted by their appraiser during the appraisal process, other than to rely on Davis. As noted previously, the Debtors' cattle were kept on the Debtors' property and on leased pasture land. Bank of America's appraiser had no way of knowing where the Debtors' production cattle were other than to rely on Davis to show him the cattle. If Davis showed Bank of America's appraiser cattle that the Debtors did not own, and indicated to the appraiser that those were the Debtors' cattle, then it is not surprising that the appraiser's cattle count is overstated. While failing to count cattle individually may result in some discrepancy with the actual number of cattle owned, it does not account for a 3,000 head discrepancy.

Thus, for the May 2000 appraisal to be overstated by in excess of 3,000 head of cattle, the Court finds that Davis must have made misrepresentations regarding the Debtors' *ownership* of cattle during the appraisal process. Specifically, the Court finds that Davis must have represented that the Debtors owned certain cattle which they did not own to the Bank's appraiser, which the appraiser then included in his cattle count. While the Debtors have raised issues surrounding the preparation of the May 2000 appraisal – *i.e.*, that Mr. Barber was relatively inexperienced at the time and has changed his appraisal procedures since that time, those issues do not explain the significant

discrepancy in cattle counts from May 2000 to July 2000. However, on this record the Court cannot find that Davis made any of the other representations the Bank contends were made by Davis during the appraisal process – *i.e.*, the Court cannot find that Davis made representations as to the number of cattle present in each pasture that he and the appraiser visited, or that when Davis did make a representation as to the number of cattle in a particular pasture, his number or count was false. In fact, Barber testified that his count of the number of cattle in a particular pasture and Davis's count were usually close.

Because the Court previously concluded that oral statements respecting ownership of cattle are "statements respecting the debtor's . . . financial condition," these misrepresentations are not actionable under the Code because they were made orally. *See* pp. 18-20, *supra*.

With respect to the November 1999 appraisal, the analysis is different. While the appraisal process is similar – *i.e.*, Davis accompanied Mr. Everett and made representations regarding the Debtors' ownership of cattle in the pastures to be counted, Davis ratified the accuracy of the November 1999 appraisal when he signed Loan Agreement-2. In fact, in Loan Agreement-2 Davis "stipulates that the livestock inventories attached collectively as Exhibit 'B' [apparently, only the November 1999 appraisal] are true, correct, complete, accurate and current." *See* Bank Exhibit 39 at ¶ I.C.1., p. 2. Thus, Bank of America has a statement in writing from Davis in which he represented that he owned 6,262 head of cattle in November 1999 and that the count was still accurate and current when Loan Agreement-2 was signed on March 9, 2000.

After a careful review of the record as a whole, the Court finds that the November 1999 appraisal was overstated and that Davis misrepresented the number of cattle the Debtors owned when he signed Loan Agreement-2. For at least the reasons set forth below, the record supports this

finding. Davis testified that he did not buy many cattle after late 1998. *See* 11/8/01 Tr. at pp. 79-80. Later in his testimony, Davis reiterated that he did not buy many cattle after the fall of 1999. *See* 11/8/01 Tr. at p. 89. Davis further testified that all proceeds of each head sold during this time period went to Bank of America, except an incremental amount to pay operating expenses. Bank of America did not receive documentation showing sales of cattle and/or loan payments sufficient to explain the significant discrepancy in cattle counts.

If the July 1999 handwritten cattle inventory was correct, as Davis testified and the Court has found based upon that testimony, and the May 2000 appraisal was overstated by approximately 3,000 head of cattle, as the parties now agree, then sometime between July 1999 and May 2000, over 3,000 head of cattle went "missing." On cross examination, Davis was simply unable to explain this significant shortage of Bank collateral

> Huffacre: If you didn't have 6,000 head [of production cattle] in May [2000], you didn't have them in November [1999] either, did you?
>
> Davis: I don't have an answer for you.

See 11/8/01 Tr. at p. 6, lines 21-24.

Because the absence of any credible explanation for this shortage of cattle was of such significance to the Court, on the last day of trial the Court asked Davis to "help it understand" how the collateral shortage could occur. Specifically, the Court and Davis had the following exchange:

> The Court: But when, Mr. Davis? Help me try and understand, because today you've told me that the July '99 inventory you did is correct, to the best of your–
>
> Davis: To the best of my knowledge.
>
> The Court: And it was done by you personally going out to the pastures and counting the cows. Admittedly, I understand that's kind of an estimation.

Davis: That's an estimation of the pasture counts of what we had put in those pastures and what we had taken out.

The Court: But – but you knew which cows within reason were yours?

Davis: Yes.

The Court: And this was your estimate?

Davis: Yes.

The Court: So if the 5,660 was off, it'd be off maybe by a little bit, but it wouldn't have been materially off because you personally were doing it; is that fair?

Davis: That's – that's right.

The Court: So how from July '99 to July 2000 do we get down to 1,800 cows? Because we have 1,000 that are sold and proceeds given to the bank. We have maybe I think we said 760 of the Florida head that were perhaps miscounted in the bunch, but there's still a big swing. So when – when did you and the bank get off in the count? Because we're correct in July of '99 and we're correct in July of 2000. So where – where did we get off?

Davis: I don't have an explan – I don't know. I do not know.

1/31/02 Tr. at pp. 103-105.

Since 3,000 head of cattle are hard to miss and do not simply disappear, and because Davis was unable to explain how he could be "short" 3,000 head of cattle, the Court finds that a strong inference can be drawn from the evidence that the November 1999 appraisal was overstated and that Davis misrepresented the number of cattle the Debtors owned to the Bank when he signed Loan Agreement-2 in March 2000 and that this misrepresentation was made with the intent to deceive the Bank. The relevant Bank loan officer testified that the Bank relied on Davis's representations regarding the number of cattle that the Debtors owned when the Bank agreed to the extension of credit evidenced by Loan Agreement-2, the Extension Agreement, and the July Letter Agreements.

Moreover, Davis testified that he knew that Bank of America was relying on his representations regarding the number of cattle the Debtors owned in their dealings with him. *See, e.g.*, 11/8/01 Tr. at pp. 55-56; p. 61, lines 12-23; p. 68, lines 1-10.

Bank of America reasonably relied on Davis's false statements concerning the number of cattle owned in electing to extend further credit to him to its detriment. If the Bank had known the true state of its collateral position – *i.e.*, that it was undersecured, the Bank may well have refused further extensions of credit to Davis. Because the extension of credit and forbearance from collection efforts were "obtained by" Davis's false representations, no further showing of damage is required. *See In re Norris*, 70 F.3d 27, 29 n.6 (5th Cir. 1995) (creditor is not required to prove that damage proximately resulted from misrepresentation; renewal of a pre-existing debt, without more, still falls within section 523(a)(2)(B)); *see also In re Campbell*, 159 F.3d 963, 966-67 (6th Cir. 1998) (a "refinancing" or "extension of credit" is sufficient without showing further damages; creditor need not also show that he could have collected on the loan prior to the bankruptcy, or the loss of a valuable collection remedy, but for the new extension of credit).

Thus, the Court concludes that the Claim is excepted from Davis's discharge in the Case in accordance with section 523(a)(2)(B).

B. Claims against Mrs. Davis

Notwithstanding the absence of evidence that Mrs. Davis was involved with the preparation and submission of the July 1999 financial statement, the July 1999 handwritten cattle inventory, the July 1999 borrowing base report, and/or the appraisal process in November 1999 and May 2000, and notwithstanding the fact that Mrs. Davis did not represent the accuracy of the November 1999 appraisal when she signed Loan Agreement-2 in her limited capacity as a "pledgor" of collateral,

Bank of America contends that the Claim is excepted from Mrs. Davis's discharge under the Fifth Circuit's recent holding in *In re M.M. Winkler & Assoc.*, 239 F.3d 746 (5th Cir. 2001). In that case, three accountants formed a partnership. One partner diverted a client's money to her own personal account, and generated fictitious income statements for the partnership to conceal the fraud. The other two partners were unaware of the fraud and did not receive any of the stolen funds either individually or indirectly through the partnership. The defrauded client obtained a state court money judgment imposing joint and several liability on the partnership and the individual partners. The "innocent partners" then filed for relief under chapter 7, and dischargeability litigation under section 523(a)(2)(A) ensued. The lower courts held the debt dischargeable because the creditor had not shown that (i) the perpetrator had acted in the ordinary course of partnership business and (ii) the innocent partners had benefitted in any way from the fraud. The Fifth Circuit reversed, holding that the Code contains no "receipt of benefit" requirement and that "the plain meaning of the statute is that debtors cannot discharge any debts that arise from fraud so long as they are liable to the creditor for the fraud." *Winkler*, 239 F.3d at 71.

In reaching its holding, the Fifth Circuit relied upon *Strang v. Bradner*, 114 U.S. 555 (1885), a case which imputed fraud by one partner to other, innocent, partners in the partnership, and barred them from discharging the debt, on the ground that each partner was an agent of the others**.** The Fifth Circuit also relied upon *Cohen v. de la Cruz*, 523 U.S. 213 (1998) in reaching its holding in *Winkler*. In that case, a debtor had been assessed both actual damages and treble damages under New Jersey's Consumer Fraud Act. The debtor asserted that only the actual damages portion of the award was nondischargeable in bankruptcy because section 523 excepts from discharge only that portion of the damages award which corresponds to the value of the money obtained by fraud. The

Supreme Court disagreed and held that "[o]nce it is established that specific money or property has been obtained by fraud . . . 'any debt' arising therefrom is excepted from discharge." *Cohen*, 523 U.S. at 218. The *Winkler* court relied upon *Cohen* to support its conclusion that receipt of benefit is irrelevant to whether innocent debtors may discharge fraud liability, and that the only consideration material to nondischargeability is whether the debt arises from fraud.

Although not expressly recognized by the *Winkler* court, *Cohen* did not deal with imputed liability at all – the debtor seeking to discharge the debt in *Cohen* was the culpable actor and was liable to his creditors directly for fraud under New Jersey law. Thus, the only question raised by the facts of *Cohen* was the *extent* of liability which a culpable actor could discharge. Although the Supreme Court did state that once money has been obtained by fraud, *any debt* arising therefrom is excepted from discharge, that language clearly requires that there be some liability from debtor to creditor, whether direct (as was the case in *Cohen*), or imputed (as was the case in *Winkler* and *Strang*). Thus, *Cohen* is factually distinguishable from both *Winkler* and this case.

Finally, the Fifth Circuit in *Winkler* concluded that its construction of the Code would effectuate

> important state law policies regarding imputed liability. Discharging the debts of the Innocent Partners under these circumstances would undermine that principle. Like many states, Mississippi 'requires that one partner make good for another partner's misappropriation of money or property while in the custody of the partnership.' States premises these laws on the notion that partners can best foresee and control the conduct of their agents. Creditors are entitled to rely on the assets of the Innocent Partners 'as a hedge against the perfidy of the agent with whom the creditor deals.' This system of risk allocation and cost internalization would be subverted by allowing the Innocent Partners to discharge their fraud liability.

Winkler, 239 F.3d at 751 (internal citations omitted).

Applying the *Winkler* court's analysis here, the policy concerns at issue there are simply not

implicated. Davis and his wife are not partners under state partnership law who have contractually agreed to be agents for one another. In fact, under Texas law one spouse is not the other's agent. The act of one spouse does not make the other personally liable for his debts solely because of the marital relationship. *See, e.g., Nelson v. Citizens Bank & Trust Co.*, 881 S.W.2d 128 (Tex. App. Houston 1994). After reviewing applicable state law, including the Texas Family Code, the *Nelson* court concluded that one spouse is personally liable for the other's debts only if the debt is for necessaries, or if the spouse expressly acts as the other's agent when incurring the debt. The *Nelson* court noted that because Texas is a community property state, either spouse "can incur contractual liability that will bind the share of the noncontracting spouse's community property subject to the sole or joint control of the contracting spouse, but the noncontracting spouse is not 'personally liable' for the obligation." *Nelson*, 881 S.W.2d at 131. *See also In re Sumpter*, 241 B.R. 640, 644 (Bankr. W.D. Mo. 1999) **(**in community property states, one spouse cannot be held personally liable for a debt incurred individually by another spouse, but a non-signing spouse's interest in joint management and control community property is subject to execution).

Principles of agency, so infused in partnership law, do not automatically apply to husband and wife under Texas state law, and there has been no showing of an actual agency relationship between Davis and his wife here. In fact, the evidence establishes that Mrs. Davis is not liable on the Bank debt at all. Davis was the "Borrower" under Loan Agreement-1 and Loan Agreement-2, and the sole obligor on Note-1, Note-2, Note-3, and Note-4. While Mrs. Davis signed the security agreements as a "debtor/pledgor," Schedule B to Security Agreement-1 explains that she is "being added as a party to the Loan Documents to make the property offered as security available to satisfy the obligations in the event of default." *See* Bank Exhibit 2, Schedule B at p. 2. The Bank made its loans to Davis,

but wanted Mrs. Davis to sign certain of its documents to ensure that its liens on her interest in the community property being pledged would be binding and enforceable against her.[13]

This case is more like *In re Allison*, 960 F.2d 481 (5th Cir. 1992) than it is like *Winkler*. The *Allison* court declined to apply an agency theory to impute the fraud of a husband to a wife in the dischargeability context, where there was no evidence as to misconduct by the wife. The *Allison* court recognized that a "debtor who has made no false representations may, nevertheless, be bound by the fraud of an agent acting within the scope of the debtor's authority," and acknowledged that it had previously imputed liability to a spouse in *In re Luce*, 960 F.2d 1277 (5th Cir. 1992) under such circumstances. But the *Allison* court distinguished *Luce* on the ground that the spouse in *Luce* was a partner in the business. The *Luce* court had made it clear that it was grounding its imputation of liability to the spouse in principles of partnership law when it stated:

> We view the imputation issue as one about business partners. It is irrelevant to the determination of the dischargeability of [the spouse's] debts under section 523(a)(2) that the business partners also enjoyed a marital relationship. The concepts of law we employ do not turn on the nature of the martial relationship, but on the nature of the business relationship....

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[13] As an independent basis for denying the Bank's requested relief against Mrs. Davis, the Court concludes that the Bank does not have a proper claim against her. Mrs. Davis is not personally liable to the Bank for her husband's loans. While she agreed that her interest in the pledged community property (*i.e.*, the production cattle) would be available to satisfy her husband's debt to the Bank, she never agreed to be personally liable on that debt. If a debtor is not liable on a creditor's debt, the creditor can have no claim against that debtor under section 523(a)(2)(B) of the Bankruptcy Code. Stated another way, a creditor cannot seek to have its debt declared nondischargeable in a debtor's bankruptcy case unless that debtor is actually liable to the creditor on the debt. The statutory language itself makes that clear. *See* 11 U.S.C. § 523(a)(2)(B)(iii) (stating that "the creditor *to whom the debtor is liable"* must have reasonably relied upon the statement)**;** *see also In re Beltran*, 182 B.R. 820 (B.A.P. 9th Cir. 1995) (husband improperly named as defendant in action under section 523 where he was not liable on wife's credit card account, even though his interest in community property would be available to satisfy wife's nondischargeable credit card debt). Because Mrs. Davis has no personal liability to the Bank on the underlying loans under Texas state law, she has no liability on the Bank's deficiency Claim and the Bank cannot seek to have the Claim declared nondischargeable in the Case against Mrs. Davis.

Luce, 960 F.2d at 1284, n.10.[14]

The *Allison* court failed to extend *Luce* to a case involving a husband and wife who were not partners in a formal business partnership. Similarly, this Court declines to extend *Winkler* beyond the partnership context, where principles of agency render each of the partners jointly liable. *See In re Villa*, 261 F.3d 1148 (11th Cir. 2001) (stating that *Winkler* was decided on principles of agency in the business partnership context, and declining to extend its reasoning to "control person" liability under Section 20(a) of the Securities Exchange Act).

Accordingly, the Court finds that the Bank failed to establish by a preponderance of the evidence that Mrs. Davis was involved in any way with the false representations made in connection with the November 1999 appraisal which only Davis ratified in Loan Agreement-2. Thus, the Court concludes that as to Mrs. Davis, the Claim is dischargeable.[15]

III. CONCLUSION

In sum, the Court finds that Bank of America has an allowed, unsecured claim against Davis in the amount of $817,168.27.[16] Davis cannot discharge this claim in the Case in accordance with section 523(a)(2)(B) of the Bankruptcy Code. All other relief requested by the Bank is denied.

A judgment consistent with this Memorandum Opinion will be entered separately.

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[14] Although *Luce* and *Allison* were both decided before *Winkler,* they retain vitality because *Winkler* is not inconsistent with either of them.

[15] This may prove to be a hollow victory for Mrs. Davis since the Claim has been held nondischargeable against her husband. The extent to which Mrs. Davis's interest in community property remains liable to satisfy the Bank's nondischargeable Claim against her husband will be decided in accordance with applicable non-bankruptcy law in the event of a subsequent dispute between the parties. The Court makes no findings or conclusions with respect to this issue in this Memorandum Opinion.

[16] The Bank apparently applied further sale proceeds to reduce the Claim after it was filed. The amount allowed in this Memorandum Opinion was taken from the Bank's proposed findings of fact and conclusions of law.

A judgment consistent with this Memorandum Opinion will be entered separately.

Signed: April 30, 2002.

BARBARA J. HOUSER
United States Bankruptcy Judge